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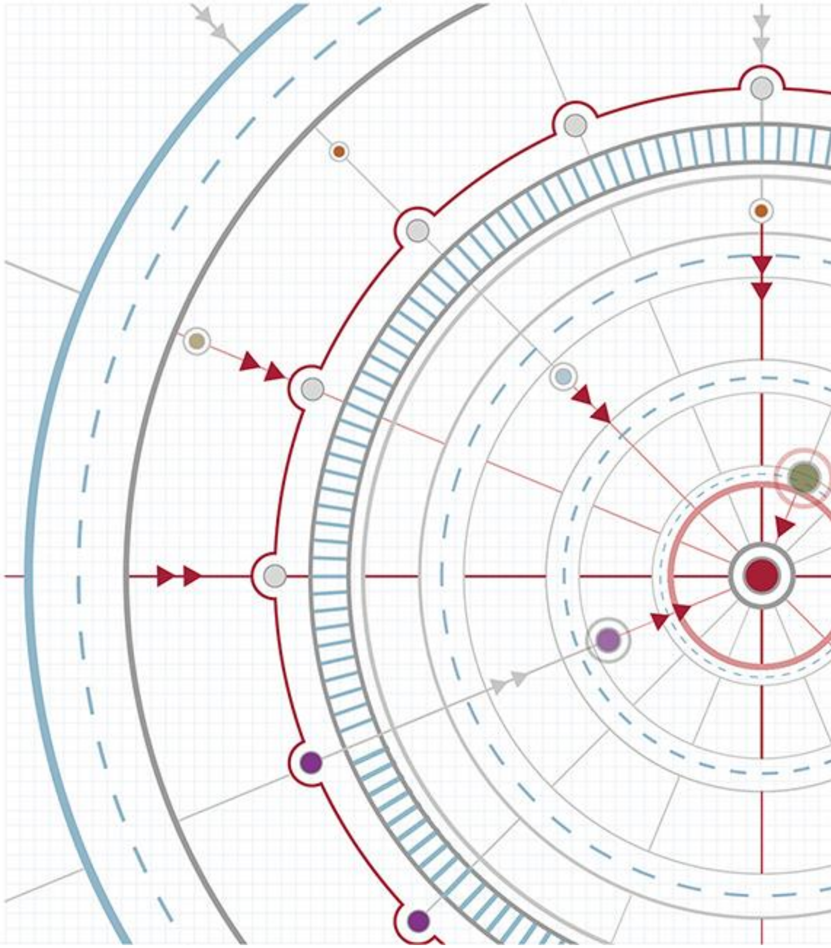


Improving effectiveness of goodwill impairment testing model

Accounting Standards Advisory Forum
September 2017

ASAF agenda paper 5B

The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board (the Board) or IFRS Foundation.

Questions to ASAF

Page	Question
20	• Do you think using the pre-acquisition headroom (PH) approach could improve the effectiveness of impairment test? • Do you have any comments or suggestions on improving the mechanics of the PH approach?
28	• Do you think using a single method, ie FVLCD or VIU, to determine recoverable amount could improve the effectiveness of impairment test? • If in most of the situations, FVLCD and VIU measurements do not produce significantly different values, is there a need for higher of the two approach for determining recoverable amount?

Introduction

Goodwill and Impairment research project

Objectives of the research project

Whether it is possible to:

- Improve the quality of information provided to users without imposing costs that outweigh benefits
- Simplify and improve application of impairment test without loss of information to investors
- Simplify separation of specified identifiable intangible assets from goodwill in a business combination

Objective of this session

Whether it is possible to:

- Improve the quality of information provided to users without imposing costs that outweigh benefits
- Simplify and improve application of impairment test without loss of information to investors
- Simplify separation of specified identifiable intangible assets from goodwill in a business combination

Why improve the impairment test?

IAS 36 requirements

- Goodwill is not amortised
- Quantitative impairment testing annually and whenever there is an indication of impairment
- Recoverable amount* to be calculated every year

Users' concerns

- Entity-specific nature of VIU and scope for passing the impairment test
- Delays in the timing and amount of impairment loss ('too little too late' issue)

Ongoing research

- Shielding effect of internally generated goodwill identified as one of the causes of 'too little too late' issue
- Considering measures to remove the shielding effect
- Using a single method for determining recoverable amount instead of higher of the two

* Recoverable amount is higher of fair value less costs of disposal (FVLCD) and value in use (VIU)

Feedback from previous discussions with ASAF

Feedback from previous discussions with ASAF

Month	Questions asked	Summary of feedback
December 2015	ASAF members were asked for feedback on the Board's initial discussions and for any advice on the way forward with the project.	• Mixed views with some members supporting impairment-only approach to goodwill whereas others supported amortisation and impairment of goodwill. • Consider what information users want; focus on the benefits for users of the current information versus the costs to preparers of applying the requirements. • Focus primarily on improving the impairment test, because such an improvement would be required regardless of the approach for accounting for goodwill. • Some ASAF members thought it necessary to retain a robust impairment test if the impairment-only approach is maintained.
		Click the links for full meeting summary and recording.

Feedback from previous discussions with ASAF (continued)

Month	Questions asked	Summary of feedback
July 2016	ASAF members were asked for views on the quantitative study presented by staff of EFRAG and ASBJ staff on trends in goodwill, intangible assets and impairment charges over ten years.	Some ASAF members: • suggested the objective and research question need to be specified clearly. • questioned whether the study provides sufficient information about internally generated intangible assets. • emphasized that it is difficult to analyse goodwill on an average basis because goodwill is concentrated among a small number of companies. • suggested reviewing goodwill on a case by case basis and performing further analysis of goodwill by industry.
		Click the links for full meeting summary and recording.

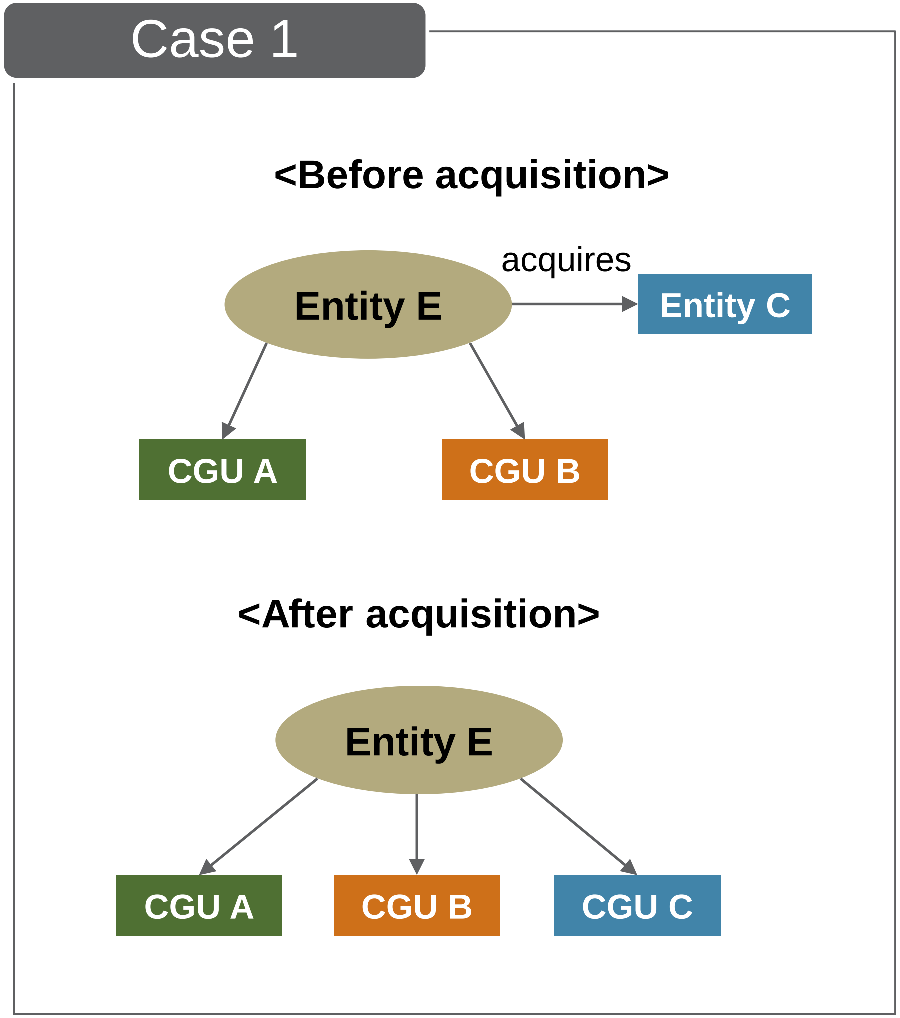
Feedback from previous discussions with ASAF (continued)

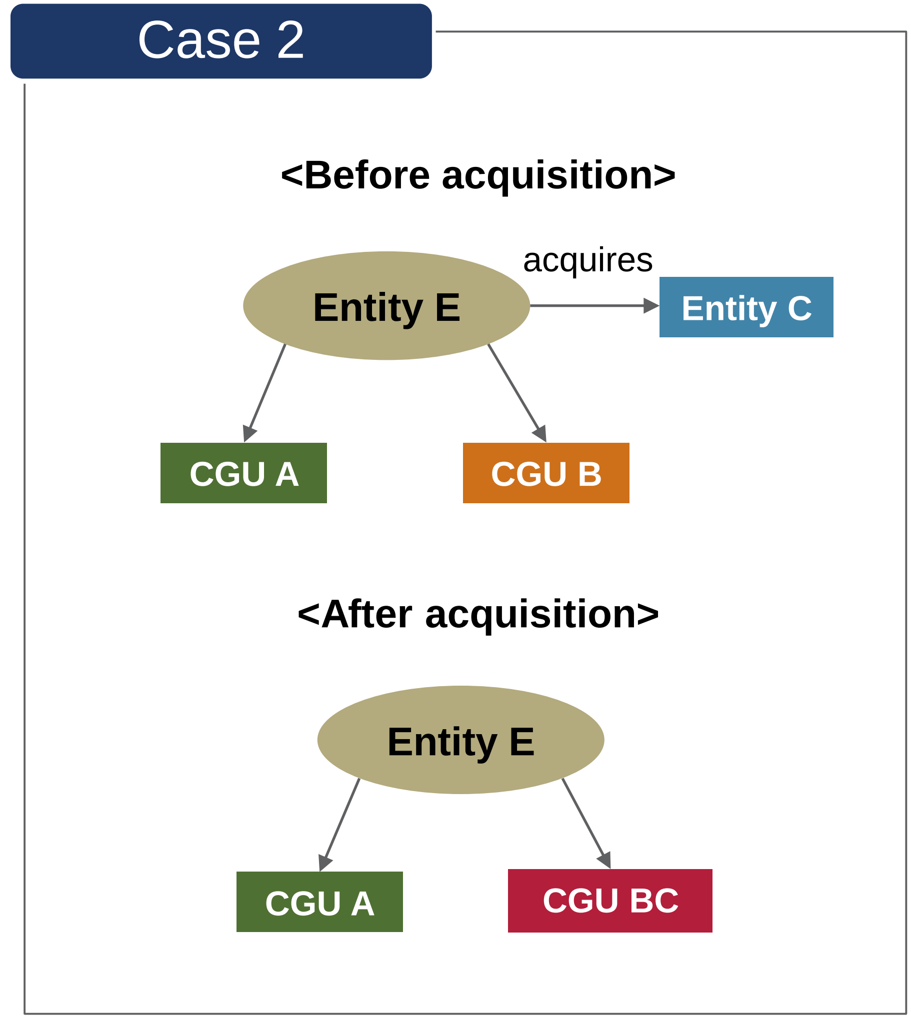
Month	Questions asked	Summary of feedback
July 2017	ASAF members were asked for feedback on the IASB staff's and ASBJ's current thoughts on simplifying and improving the effectiveness of the impairment testing model for goodwill.	• ASAF members generally did not support the ASBJ's idea of allowing a choice between amortisation and impairment model and impairment-only model mainly because of deteriorating comparability and other concerns. • Mixed views on single method approach and indicator-only approach to simplify and improve goodwill impairment testing.
		Click the links for agenda papers 3–3B and recording.

The pre-acquisition headroom approach

See paragraphs 25–27 and Appendices A and B of Agenda Paper 18D of the July 2017 Board meeting

Possible scenarios in an acquisition





What is the shielding effect?

Case 1

- Entity C is a separate CGU
- Assume that all of the purchased goodwill is allocated to that CGU
- There are no pre-acquisition unrecognised internally generated assets or goodwill that shield the purchased goodwill
- Arguably, newly internally generated goodwill of CGU C shields the purchased goodwill from impairment

Case 2

- Entity C is not a separate CGU
- Existing CGU B and Entity C are grouped as a single CGU BC to which all of the purchased goodwill is allocated
- The new CGU BC includes the pre-acquisition unrecognised internally generated assets and goodwill (pre-acquisition headroom or PH), if any, of CGU B
- That PH of CGU B shields the purchased goodwill by absorbing any negative movements in the recoverable amount of the new CGU BC
- Arguably, newly internally generated goodwill of CGU BC also shields the purchased goodwill

How does the PH approach work?

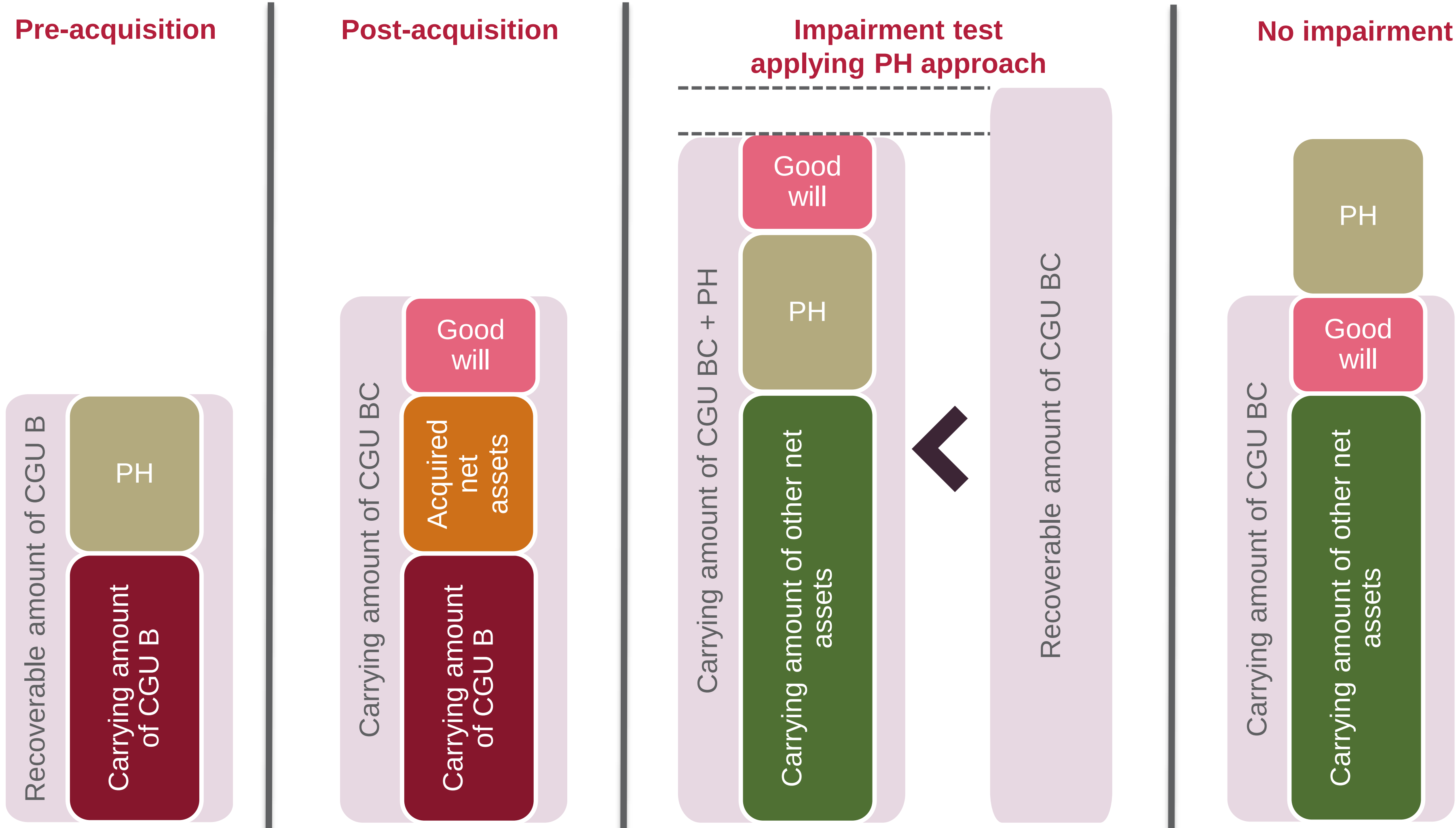
- PH approach aims to prevent the shielding effect of pre-acquisition internally generated goodwill or assets of existing CGUs

Pre-acquisition headroom in CGU BC = Recoverable amount of CGU B − Carrying amount of CGU B

- Basic mechanics of the PH approach:
    1. Measure the PH of CGU B immediately before the acquisition (the PH is never recognised in the financial statements)
    2. The PH is added to the carrying amount of CGU BC every time CGU BC is tested for impairment (PH is included only for impairment testing)
    3. Compare the carrying amount (including the PH) with the recoverable amount of CGU BC in calculating impairment loss, if any

See paragraphs 25–27 and Appendices A and B of Agenda Paper 18D of the July 2017 Board meeting

Application of PH approach—Year 1



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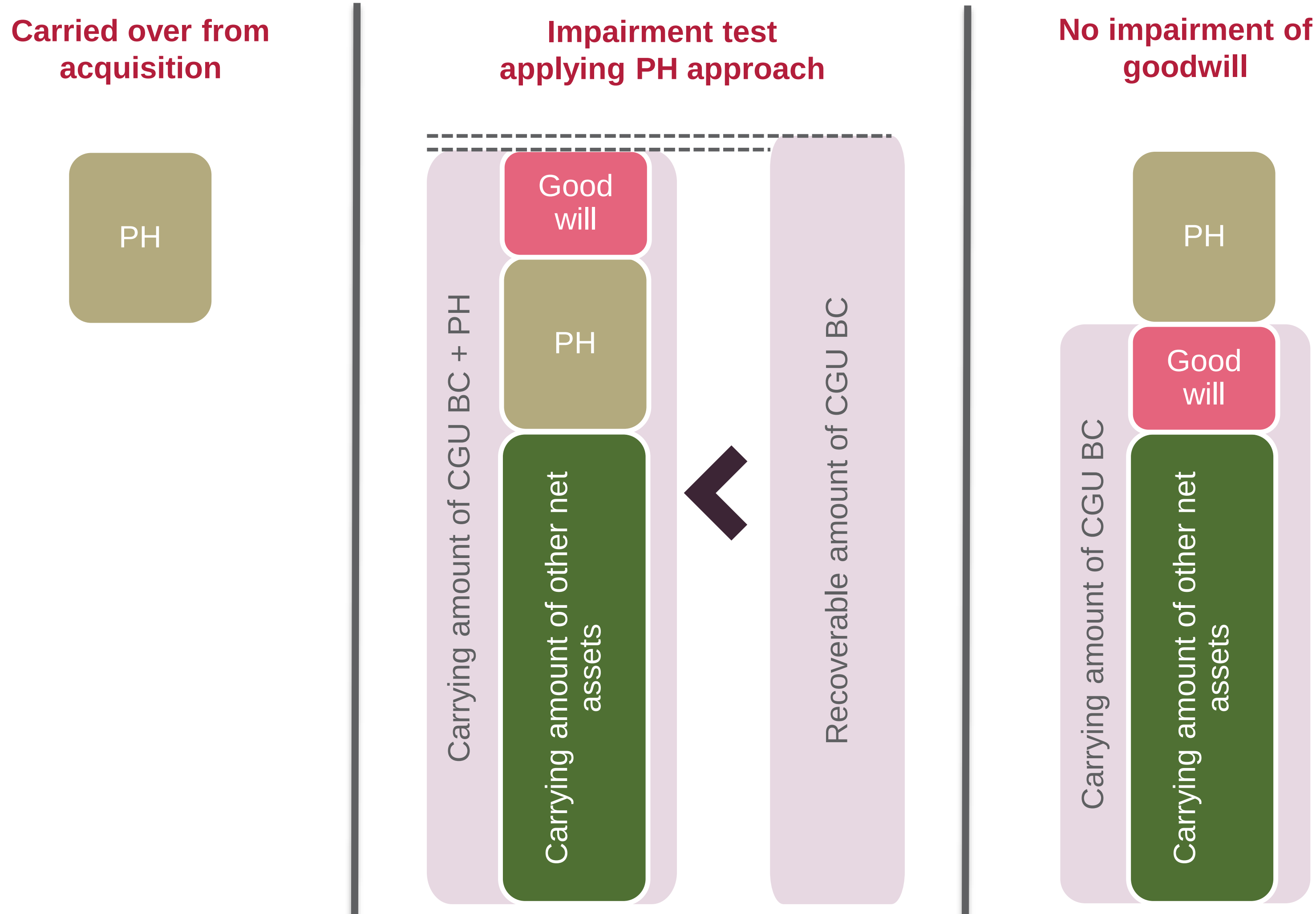
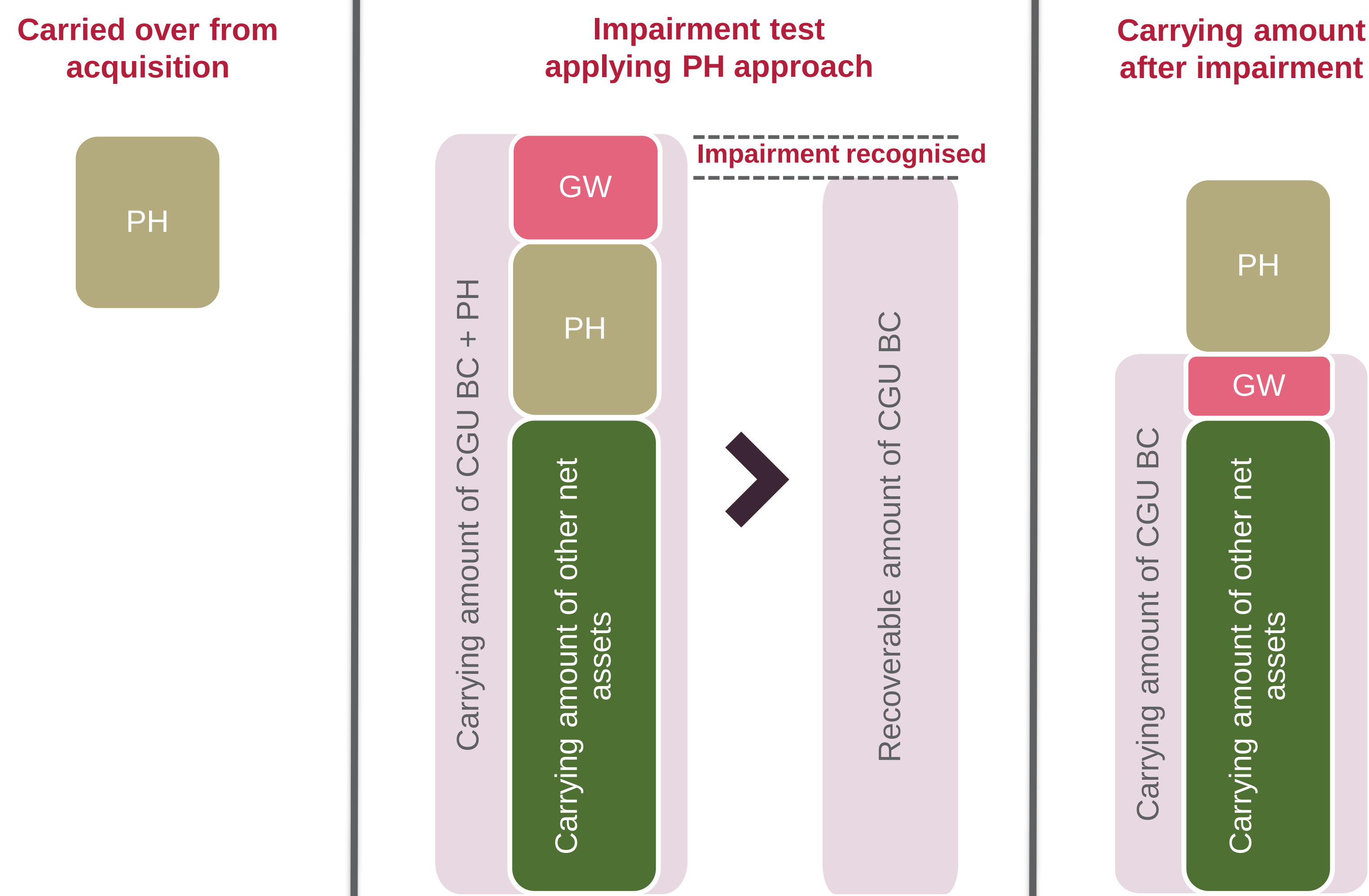
Application of PH approach—Year 2

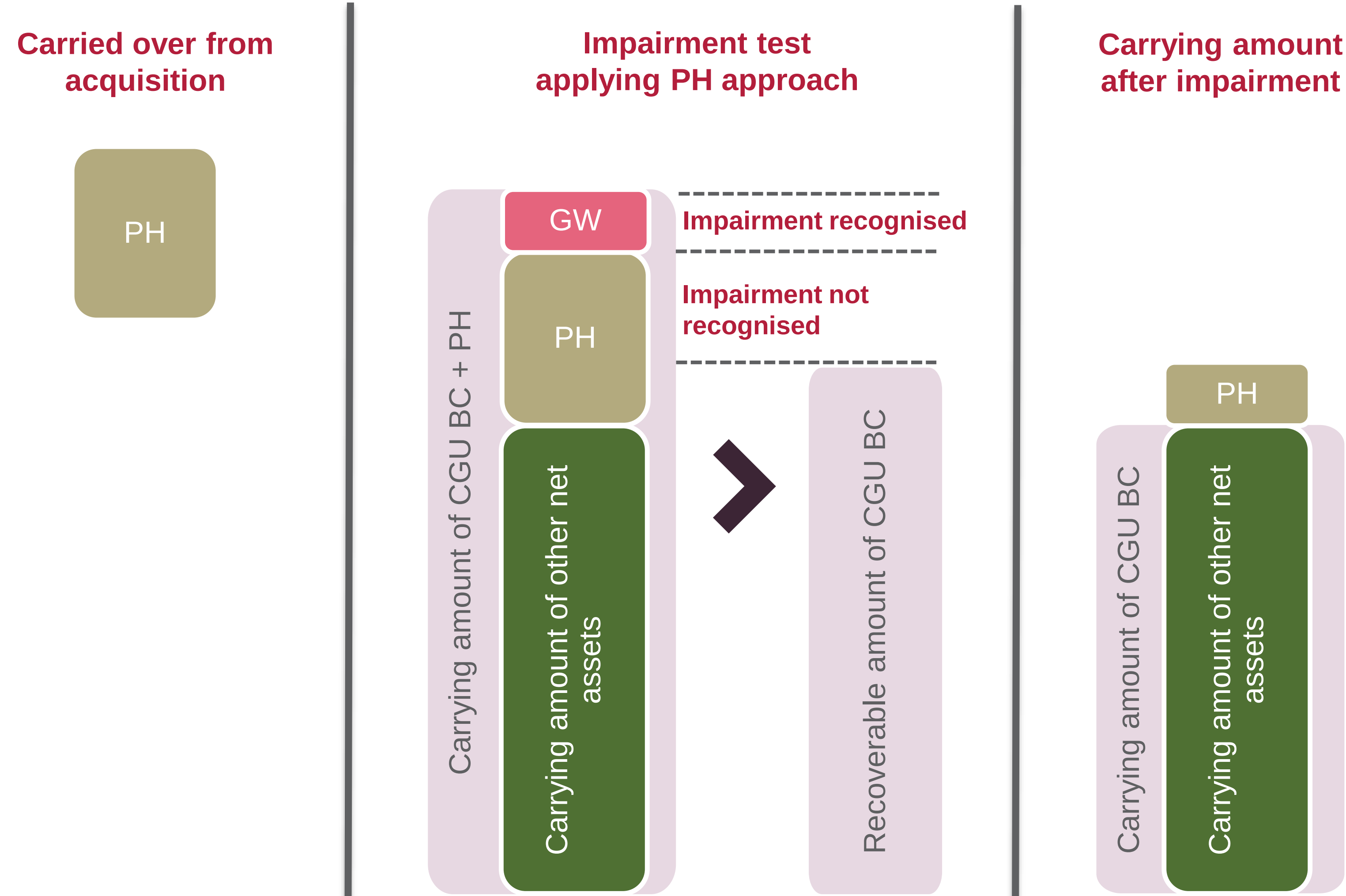


Application of PH approach—Year 3



See paragraphs 25–27 and Appendices A and B of Agenda Paper 18D of the July 2017 Board meeting

Application of PH approach—Year 4



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Pros and Cons of the PH approach

Pros	Cons
• Leads to earlier recognition of impairment losses • Measurement of the PH would be a one-off cost at the time of acquisition • Will be most effective in the first impairment test after an acquisition because this test will be performed soon after the PH is measured	• As the PH is determined on acquisition and not updated after acquisition, the approach cannot remove any increase in the shielding effect of newly generated goodwill after acquisition • It adds complexity to the impairment test

See paragraphs 25–27 and Appendices A and B of Agenda Paper 18D of the July 2017 Board meeting

Questions to ASAF members

- Do you think using the PH approach could improve the effectiveness of impairment test?
- Do you have any comments or suggestions on improving the mechanics of the PH approach?

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Single method for determining the recoverable amount

Briefly discussed by ASAF at its July 2017 meeting

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Staff current thoughts—single method

Single method for determining recoverable amount instead of higher of the two

FVLCD as the sole basis	OR	VIU as the sole basis	OR	FVLCD or VIU depending on how an entity expects to recover the asset

Staff current thoughts—single method

(continued)

Feedback from a few users	concerned about entity-specific nature of VIU and scope for management to pass the impairment test
	a fair value based impairment model would be more objective
Feedback from a few preparers	VIU better reflects the fact that an entity holds the assets for continued use in the business
	Like FVLCD, VIU is a reflection of range of economic conditions and not just the best case scenario
Other feedback	a few auditors concerned about the difficulty in challenging management's best estimates used in VIU calculation
Using a single method might improve effectiveness of the test and could:	make the test easier to apply and understand; and
	reduce concerns that current model makes it easy to delay and (or) conceal impairment

Staff current thoughts—single method

(continued)

Do VIU and FVLCD approximate each other?

	VIU calculation	FVLCD calculation	Staff current thoughts
Overall approach	Management's best estimates	Level 3 inputs	Level 3 inputs may not be significantly different from management's best estimates
Valuation model	Discounted cash flow	Generally based on discounted cash flow techniques	
Cash flow projections	• Reasonable and supportable assumptions and giving greater weight to external evidence • Prohibition on including cash flows from expected future restructurings or from improving or enhancing the asset's performance	All future cash flow projected using best available information, which might include entity's own data, and taking into account reasonably available market participant assumptions	• The cash flow projections are not likely to be different except for the cash flows prohibited in VIU calculation • Stakeholders' requests for removing the prohibition • In practice, it is unclear whether the prohibitions create a difference between FVLCD and VIU

Staff current thoughts—single method
(continued)

Do VIU and FVLCD approximate each other? (continued)

	VIU calculation	FVLCD calculation	Staff current thoughts
Discount rate	• IAS 36 requires the use of a pre-tax discount rate • Stakeholders' feedback that pre-tax discount rate is not meaningful	A post-tax discount rate is generally used	In practice, the same discount rate is used for both VIU and FVLCD calculations
Entity-specific synergies	Included	Not included	• Arguably, any synergies considered in VIU but not in FVLCD calculation could raise questions on identification of the unit of account [CGU(s)] • FVLCD calculation assumes availability of: – any complementary assets and associated liabilities; and – synergies from using assets as a group in an ongoing business to market participants

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Staff current thoughts—single method
(continued)

Do VIU and FVLCD approximate each other? (continued)

	VIU calculation	FVLCD calculation	Staff current thoughts
Costs of disposal	Considered and are discounted because the asset is assumed to be sold in the future, possibly at the end of its useful life	Considered but are not discounted because the asset is assumed to be sold immediately	At the point at which an entity decides to dispose of the asset, costs to sell do not create any difference between the two amounts and VIU and FV are very likely to be equal

Feedback from ASAF in July 2017

- In considering the single method, consider the possible effect on other non-current assets within the scope of IAS 36
- No enough evidence on whether there are significant differences in practice between VIU and FVLCD
- VIU better reflects the value of assets that an entity plans to use in its business and may not be any less objective than Level 3 FV
- Some industries prefer the use of FVLCD because of the prohibition on specified cash flows to be used in VIU calculation

Questions to ASAF members

- Do you think using a single method, ie FVLCD or VIU, to determine recoverable amount could improve the effectiveness of impairment test?
- If in most of the situations, FVLCD and VIU measurements do not produce significantly different values, is there a need for higher of the two approach for determining recoverable amount?

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